

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2765

AUDIT REPORT
OF
INDIANA DEPARTMENT OF REVENUE
STATE OF INDIANA
July 1, 2003 to June 30, 2004



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AGENCY OFFICIALS

Office

Official

Term

Commissioner

Mr. Kenneth L. Miller

01-09-01 to 01-10-05



STATE OF INDIANA

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STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2765

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF THE INDIANA DEPARTMENT OF REVENUE

We have audited the records of the Indiana Department of Revenue, for the period July 1, 2003, to June 30, 2004, and certify that the records and accountability for cash and other assets are satisfactory to the best of our knowledge and belief except as stated in the Audit Results and Comments. The financial transactions of this office are reflected in the Indiana Comprehensive Annual Financial Reports.

STATE BOARD OF ACCOUNTS

December 7, 2004

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
June 30, 2004

INTERNAL CONTROLS OVER CONTRACT PAYMENTS

As part of our audit of the Department's contract disbursements, we reviewed seven contracts. We found overpayments totaling \$8,662.89 made to vendors for two of these contracts. These overpayments were the result of two duplicate claims and other payments made in excess of contract terms.

Prior to our exit conference, the Department received full reimbursement for the stated overpayments in the amount of \$8,662.89. (See Summary, on Page 13)

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and record, effectiveness and efficiency of operations, and proper execution of management's objectives. Each agency is also responsible for compliance with applicable statutes, regulations, contract provisions, state policies, and federal requirements. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

ATTENDANCE REPORT RECORDS

For our review of the Department's attendance reports, we requested on June 28, 2004, payroll records for two pay periods. These records should have been readily available, yet these documents were provided to us three weeks later on July 19, 2004. We found that 4% of employee attendance reports were signed and/or dated prior to the last day worked by the employee and/or supervisor. In addition, on at least three of those attendance reports, the supervisor had approved these employees' attendance reports subsequent to our request. Therefore, the validity and reliability of these records are in question.

Employee attendance reports should not be signed or dated prior to the last day worked in a pay period. After being completed by the employee, the attendance report should be reviewed, signed, and dated by the immediate supervisor of the employee prior to submission of payroll to the Auditor's Office. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 9)

Documents must be filed in such a manner as to be readily retrievable or otherwise reasonably attainable, upon request, during an audit. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and record, effectiveness and efficiency of operations, and proper execution of management's objectives. Each agency is also responsible for compliance with applicable statutes, regulations, contract provisions, state policies, and federal requirements. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

DISTRICT OFFICE FINANCIAL REPORTING

The Department has district offices located throughout the state that collect tax revenue. Each office deposits daily collections at a local depository and has been instructed to submit by fax or email a report of financial activity to the Controller's Division daily. The Division needs these reports to determine the amount of funds to be transferred from the local banks into the Treasurer of State's account.

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

During our review of the district offices, we learned that the financial activity reports were not always submitted daily. In fact, according to the Division ledgers for the three months of activity we reviewed, several offices were late in faxing their daily reports from six to thirty-one days after the date of activity. District office delays in submitting financial activity reports may result in loss of revenue to the State's General Fund.

Controls over the recording and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision-making. An agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 3)

MONITORING OF DISTRICT OFFICES

The Audit Division implemented the Department's Accounting for Cash/Checks procedures at district offices. Each office is to submit a monthly Certification of Funds Accounting System attesting to compliance with the procedures and to identify any resolved and unresolved issues. The Audit Division depends on these certifications to monitor the financial activity of the district offices.

We reviewed all submitted certificates for a twelve-month period. Almost half of the offices submitted no certifications during the review period and another one-third submitted them months late or in bi-yearly batches. The Audit Division cannot adequately monitor the district offices without proper receipt and review of monthly certifications.

Each agency, department, institution or office also has the responsibility to comply with their own internal policies and guidelines. These internal policies and guidelines cannot conflict with state or federal laws, state policies or procedures (including those in this manual) or other policies established by Department of Administration, Department of Personnel or through the Financial Management Circulars. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INTERNAL CONTROLS OVER TAX REFUNDS

The Department has three types of tax refund processes: RPS system-generated, RPS manual, and Non-RPS manual refunds. RPS system-generated and RPS manual refunds have basically the same process; Non-RPS manual refunds are processed differently.

Untimely Review Process

During our review of tax refunds, we discovered that the Compliance Division requires RPS system-generated and RPS manual refund checks to be held for two days before they are mailed to the taxpayer in order to detect potential errors. This review process should occur prior to the checks being printed.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

Inadequate Segregation of Duties

Also during our review of tax refunds, we found that for Non-RPS manual refunds, the same employee in the Compliance Division who submits the refund claims to the Auditor of State also receives the refund checks from the Auditor of State for distribution. This lack of segregation of duties could allow fraud to go undetected.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

1099 REPORTING OF ATTORNEY COLLECTION FEES

The Department has service contracts with attorneys for collection of delinquent taxes. Taxpayers may submit delinquent tax payments, including base tax, penalty, interest, and collection fees, to these attorneys. As stated in the current contracts (which began January 1, 2003), the attorneys retain their collection fees and remit net tax payments to the Department.

We found that by having attorneys remit net collections, the Department has by-passed the Auditor of State's system for reporting taxable income on Form 1099 to the Internal Revenue Service and the Indiana Department of Revenue. Therefore, under the current contract provisions, 1099s have not been issued for retained attorney collection fees for calendar year 2003 and steps have not yet been implemented to ensure issuance of 1099s for 2004. We consider these fees 1099 reportable.

The Auditor of State must report certain types of payments to the Internal Revenue Service. The Auditor of State issues the 1099 reports based upon coded entries from expenditure documents. Each agency must determine whether vendor payments/services are considered 1099 reportable. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 5)

AGENCY COLLECTION SERVICE CONTRACTS

The Department also has service contracts with collection agencies. These contracts state that the agency is to remit gross collections and the Department then pays the agency its collection fees by claim voucher through the Auditor of State.

For our entire audit period, the Department allowed the agencies to retain their collection fees and only remit net tax payments. This is in violation of contract terms. In addition, the Department has been paying for agency collection services without a valid contract since July 1, 2004.

Each agency is responsible for compliance with applicable statutes, regulations, contract provisions, state policies, and federal requirements. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
June 30, 2004
(Continued)

INTERNAL CONTROLS OVER IFTA/MC REVENUE

As stated in our prior Audit Report B22493, we again found that batches used for the Department's IFTA/MC revenue processed at the Motor Carrier Services Division were not closed daily. This procedure reduces connectivity between batched return totals and daily revenue deposits.

Controls over the receipting, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions and inaccurate records and financial statements. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 3)

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

WITHHOLDING RECONCILIATION

As stated in previous reports (most recently B22493 and B20208), the Department's internal controls over the reconciliation of income tax withholding did not guarantee that adequate compliance was being maintained. Controls are still not adequate and may allow discrepancies to go undetected.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 3)

DAILY DEPOSITS

As stated in previous reports (most recently B22493 and B20208), the Department did not consistently deposit receipts collected for most tax remittance types within the following business day.

IC 5-13-6-1(b) states in part: ". . . all public funds . . . shall be deposited with the treasurer of state, or an approved depository selected by the treasurer of state not later than the business day following the receipt of the funds."

INDIANA DEPARTMENT OF REVENUE
EXIT CONFERENCE

The contents of this report were discussed on December 14, 2004, with Mr. Kenneth L. Miller, Commissioner. The official response has been made a part of this report and may be found on pages 9 through 12.



STATE OF INDIANA

DEPARTMENT OF REVENUE OFFICE OF THE COMMISSIONER

Indiana Government Center North
100 North Senate Avenue, Room N248
Indianapolis, Indiana 46204-2253

January 4, 2005

Mr. Charles Johnson, III, State Examiner
State Board of Accounts
Indiana Government Center South
302 W. Washington Street, E418
Indianapolis, IN 46204

Dear Mr. Johnson

Attached please find the Indiana Department of Revenue's official response to the 2003 Audit by the State Board of Accounts. If I can be of further assistance, please contact me at your convenience.

Sincerely

A handwritten signature in cursive script, reading "Kenneth L. Miller".

Kenneth L. Miller
Commissioner

Enclosure

"Equal Opportunity Employer"

INTERNAL CONTROLS OVER CONTRACT PAYMENTS

The cited overpayments (\$8,662.89) were the result of human error and failure of internal controls. In addition, all monies have been recouped. The following steps have been taken:

1. DOR has reiterated in writing the proper procedures for verifying invoice charges against contract amounts prior to payment, i.e. including reporting all discrepancies to management staff and resolution of all issues before payment.
2. The personnel involved have been counseled in writing as to the procedures and the importance of accuracy in all accounting processes.
3. A computer program has been developed and implemented to check potential payments against the Department's Document Control Register records to insure duplication of payments is not made.

ATTENDANCE REPORT RECORDS

The Department has reminded supervisors of our policy regarding attendance reports including signatures. We are also pursuing an electronic signature process that should improve the Department's approval of attendance reports.

DISTRICT OFFICE FINANCIAL REPORTING

This situation has been totally eliminated and revamped. The Audit Division has discontinued the practice of depositing in a Revenue bank account. We have instituted depositing directly into the State of Indiana Treasurer's bank accounts. All deposits slips are faxed to Cashiers section. This modification eliminates the loss or delay in the State's ability to use its funds.

MONITORING OF DISTRICT OFFICES

Currently the District Office Field Supervisor is responsible for certification of funds; reports are to be mailed into the Central Office. We will be training an additional person (which will bring the total to two) who will be responsible for the auditing of the funds certification statements.

INTERNAL CONTROLS OVER TAX REFUNDS

Untimely Review Process

The Department of Revenue holds refund warrants for two days after they are created by the Auditor's Office before mailing in order to perform a final quality control check. The warrants are stored in the locked Controller's conference room in the limited access IGCN248 offices. The following is the procedure to ensure that all warrants are accounted for:

1. Auditor's office provides a printout with the warrants when they are picked up by DOR personnel who detail the warrant number range and total number of warrants.
2. DOR records any warrants pulled out of the batch for any reason and documents where internally they were sent on the documentation from the Auditor's office.
3. Once the two day waiting period has passed, the mailing vendor picks up the warrants and signs a receipt detailing the number of warrants given to him.
4. The vendor runs the warrants through his postage metering equipment which provides a count of the number of pieces processed.
5. Should there be a discrepancy between the number of warrants metered and the number indicated on the receipt, DOR is immediately notified.

DOR personnel work with the vendor to reconcile the discrepancy. The entire batch of warrants is held until the discrepancy is resolved.

Inadequate Segregation of Duties

Employees in the Compliance Division handle the function of non-RPS manual refunds. There is a primary employee assigned to this function with two trained back-up employees.

The current process requires that a copy of the refund package taken to the Auditors' Office is provided to the Departments' Controllers Division.

Effective January 1, 2005, the employee will submit the refund request claims to the Auditor of State. The Supervisor or Deputy Administrator will handle the receipt of checks from the Auditor of State. Upon approval by the Supervisor or Deputy Administrator, the checks will be released for distribution.

1099 REPORTING OF ATTORNEY COLLECTION FEES

The Department has met with representatives from the Auditor of State's Office and provided them with a report for all collection fees that were retained for 2003. Procedures have been established to provide this information to the Auditor of State by mid-January and each year hereafter for collection fees retained. This procedure should ensure that the Auditor of State has the required information to issue 1099s for the all of the Department's collection fees retained.

AGENCY COLLECTION SERVICE CONTRACTS

1. Discrepancy between the contract terms and the practice of retention of fees by the collection agencies:

A verbal agreement was entered into between the DOR and the two collection agencies on or about 1/1/03 to allow the collection agencies to retain their fees before remitting the balance collected to the state. The DOR failed to make a contract amendment to implement this change.

The new contracts will have the appropriate verbiage to cover this change in procedure. Further, all users of contract services within DOR have been reminded that any and all changes to contract terms must be communicated to the procurement division of the Controller's office for the processing of an appropriate contract amendment.

2. Department continuation of payment for agency collection services without a valid contract since July 1, 2004.

Original Collection Agency Service contracts were put in place 7/1/00 for a term of two years. They subsequently renewed for a second term of two years and expired 6/30/04. Dept of Administration procurement procedures were followed and a RFP (#4-57) was duly issued and was in process at the recommendation stage when the Dept of Administration's requirements changed. DOA cancelled the RFP and issued a new RFP (#5-39) on behalf of the Dept of Revenue on 11/8/04. By this time the contracts had expired. The new RFP bids have now been received for evaluation (as of 12/13/04) and will be awarded as soon as practicable.

INTERNAL CONTROLS OVER IFTA/MC REVENUE

A full time cashier has been hired to provide more consistent enforcement of the Department's policies. Also, we have a meeting scheduled for Jan. 4, 2005 to ensure every one has an understanding of the importance of closing batches with money daily.

WITHHOLDING RECONCILIATION

The Department continues to review withholding accounts for validity. Statistical samplings of employers who file magnetic media are being conducted. Efforts to improve the PC-based program for downloading magnetic media are currently under development. Returns identified by the system to be reviewed by a user are examined; employer identification numbers are checked for validity and withholding registration.

Meanwhile, the Returns Processing System automatically verifies monthly withholding remittance to the annual withholding reconciliation return. If a discrepancy exists, the account is flagged for a user review.

DAILY DEPOSITS

Each year the Returns Processing Center strives to deposit funds within 24 hours of receipt. During the peak period in April alone, the Department receives approximately one million (1,000,000) returns. Nevertheless, the Department will continue to use as many resources as operationally possible in an effort to meet 100% of funds deposited by the next business day.

INDIANA DEPARTMENT OF REVENUE
SUMMARY

	<u>Charges</u>	<u>Credits</u>	<u>Balance Due</u>
Contract Overpayments (See Internal Controls Over Contract Payments, Page 4)	\$ 8,662.89	\$	\$
Credit Memo, July 14, 2004		36.32	
Repayment, August 26, 2004		8,600.00	
Credit Memo, November 11, 2004		26.57	-
	<u> </u>	<u> </u>	<u> </u>
Totals	<u>\$ 8,662.89</u>	<u>\$ 8,662.89</u>	<u>\$ -</u>